

WHY IS YOUR VETERINARY REAL ESTATE WORTH SO MUCH?



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REAL ESTATE INVESTMENT SERVICES

An increase in the number of pet owners is driving the need for better access to care and improved treatment options for companion animals, resulting in more pet health spending and market growth. The U.S. pet industry's overall spending increased to \$99 billion in 2020 from \$95 billion in 2019, a five percent increase year-over-year. From 2019 to 2020, about 67 percent of households in the U.S. owned a pet, equal to approximately 84.9 million homes. This percentage has increased by about 11 percent since 1988, where only 56 percent of households in the U.S. owned a pet. According to the President and CEO of APPA, millennials have continued to be the largest pet-owning demographic in the country. They are willing to pay more for quality products and services to improve their pets' health and well-being. More than ever, pet owners see their animals as members of their families, and as a result, the pet care industry continues to grow. With that growth, the newly monitored veterinary real estate industry has started to take shape. The following article explores the veterinary real estate market and the various scenarios where practices can create additional value.





THE VETERINARY REAL ESTATE MARKET

Oftentimes, veterinarians own not only their practice but also their real estate. And equally as often, owners do not realize how valuable their real estate has now become. Over the past two to three years, the veterinary real estate market has been trending up, and in recent months it has caught fire. The growth of the industry, along with the subsequent struggles of other real estate classes, such as retail, have propped-up the veterinary real estate market. So much so that many veterinary assets are trading at higher rent multiples than traditional, well-positioned retail sites. There is currently an excellent market for veterinary real estate and a scarcity of suitable properties for investors looking to enter the market.

With more demand for veterinary real estate than ever before, there has been an influx of private and institutional real estate investors looking to enter the space. This perfect storm of activity has drastically increased asset value and positioned veterinary real estate owners to take advantage of the market in a potential real estate sale.



STRENGTHS OF BUYING VETERINARY REAL ESTATE



E-COMMERCE, RECESSION, AND PANDEMIC-PROOF

Veterinary real estate is considered e-commerce, recession, and pandemic-proof. While they were authorized to provide service during the pandemic, animal hospitals and veterinarian practices did not escape its disruption. In the first six to eight weeks of the pandemic, business dropped around 50 percent for most veterinarian practices as they adjusted to the new norm. This adjustment included setting up roadside pet pick up and creating processes to mitigate virus spread. Since then, veterinarians have been busier than ever, with many operators showing their highest sales figures in years.

SOME CLINICS HAVE SEEN A 25% INCREASE IN REVENUE DURING THE HEIGHT OF COVID-19.

Despite COVID-19's financial uncertainty, there has been an increase in pet adoption, as many found themselves with extra time at home and sought companionship. As the animals grow older in their new homes, a short-term decrease in demand for vet services due to the pandemic will translate to a permanent increase in demand as veterinary practices gain new patients for life. Some veterinarians have seen new clients up 25 percent from last year, despite COVID-19 disruption.



PROVEN BUSINESS MODEL

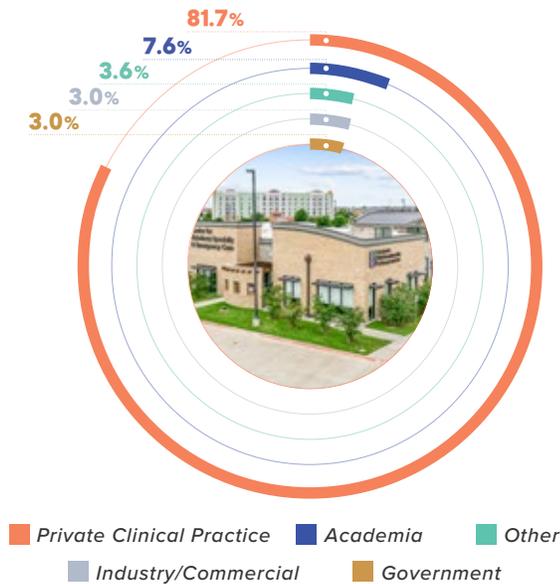
Along with being e-commerce-resilient, the service provided by veterinarians and animal hospitals has a proven business model. Although COVID-19 has altered how vets conduct visits, there will always be a demand for professional pet care. With more people staying at home, relying on their pets for support, and having their pets depend on them, many find time to bring their animals in for delinquent medical care. People are also paying closer attention to pets as they remain at home and trust veterinarians to relieve pets of discomfort.



HIGH MOVING COSTS

As a specialized business with build-to-suit spaces, in most cases, veterinarians have high moving costs. So, if a practice were to move, the tangible financial cost of doing so would be high. On top of that, the veterinary clinic clients typically live within a five-mile radius in surrounding neighborhoods. Therefore, if a veterinary clinic moves to a different market or submarket, the intangible financial cost would be incredibly high as they risk losing clients.

PRACTICE SETTING OF CALIFORNIA VETERINARIANS



SOURCE: UCOP

Given the strengths of buying veterinary real estate, private equity firms and multi-unit operators have flocked to the sector. Private equity firms are backing large, multi-unit operators that are acquiring successful practices and locations due to the proven business model and recession-resistant industry. Further, there are strong guarantors behind the lease due to the high-moving costs, making the sector even more enticing for investors.

STRENGTHS OF SELLING VETERINARY REAL ESTATE

CAPITALIZE ON LONG-TERM NNN LEASE

Many veterinary owner-operators have built up their practice by taking ownership of the real estate, then growing their practice within it. Typically, they own both parts of the equation, the real estate, and the veterinary business. Veterinary owners are often surprised to learn that a sophisticated investor may value their building more than the standard real estate appraisal. Fortunately, when a multi-unit operator proposes to acquire a veterinary practice, they are solely focused on the business, not the real estate. Therefore, investors are willing to pay premiums for the real estate of successful veterinary practices. These investors want to add the business to their portfolio for the long-term. To do so, buying a practice from a veterinarian and simultaneously signing a long-term lease has become increasingly attractive. This long-term lease is usually NNN and is very marketable to the outside investor.

MAXIMIZE VALUE THROUGH A SALE LEASEBACK

A growing number of veterinarians are looking to structure a sale leaseback as a way to free up the maximum amount of equity in their property. A sale leaseback is a financing tool that allows an owner-operator to sell their real estate interests to a buyer and simultaneously sign a long-term lease as a tenant

in order to secure the location and operate at the property long-term. In simpler terms, a sale leaseback occurs when you sell a property you operate out of and sign a lease with the buyer who acquires the property.

By separating the real estate from their core business, veterinarians can achieve significantly higher real estate values. While each veterinary group has a unique set of goals that they look to accomplish, one of the main driving factors for a sale leaseback is flexibility. Veterinarians can sell their real estate while still having the freedom to partner their practice with a multi-unit operator down the line. The owner-operator can also structure their lease, whether they want a term longer than ten to 15 years or a rental income that is higher than what a multi-unit operator has proposed, they have the freedom to decide. This structure gives the owner-operator full reign to structure the lease how they want it. Another advantage of selling veterinary real estate through a sale leaseback is allowing the veterinarians to pull out 100% of the equity while still controlling the business and reinvesting into another project. We see some veterinarians look to use the capital to open other practices, expand their current practice, or acquire another practice or piece of real estate. Sale leasebacks are being used across the healthcare industry and are starting to become more prevalent in the veterinary industry, demonstrating the numerous benefits of a sale leaseback.



ABOUT **54%** OF PET OWNERS SAY LOCATION IS AN IMPORTANT FACTOR WHEN SELECTING THEIR CURRENT VETERINARIAN.



With the review of the strengths of buying and selling veterinary real estate, an investor or veterinary practice owner can see the benefits of selling the real estate independently of the practice. **THIS CAN EASILY BE COMPLETED BY PERFORMING A SALE LEASEBACK TRANSACTION, WHICH ALLOWS OWNERS OF REAL ESTATE ASSETS TO SELL AN ASSET TO RAISE CAPITAL AND THEN LEASE THE ASSET BACK FROM THE PURCHASER.** Today's environment provides veterinarians the ability to maximize value in accordance with increased demand. For more information regarding the veterinary market and sale leaseback transactions, please contact a specialized Matthews™ agent.

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